

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Padilla Analyst: Jahna Alvarado Bill Number: SB 867
Related Bills: See Legislative History Telephone: 845-5683 Introduced Date: February 18, 2011
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Build California Bonds Credit

SUMMARY

This bill would establish the Build California Bonds (BCB) Program and would create a nonrefundable franchise or income tax credit for holders of a BCB.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

Summary of Suggested Amendments

Amendments are needed to provide definitions, clarify administrative responsibilities, and provide consistency with existing credit language and drafting style. See "Implementation Considerations" below.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to raise capital to make transportation improvements and create new jobs.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2012, and for purposes of the tax credit would be specifically operative for calendar years beginning on or after January 1, 2012.

ANALYSIS**FEDERAL/STATE LAW**

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations.

Board Position:

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Executive Officer

Date

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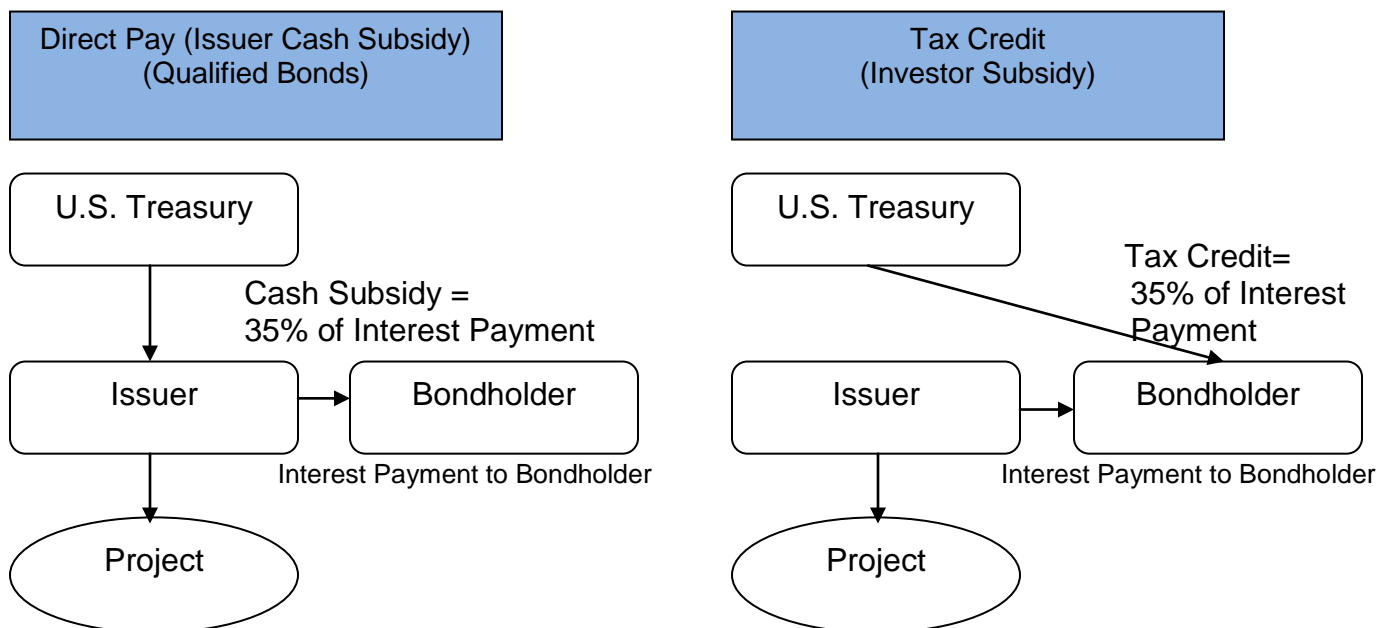
Generally, under federal law, all bond interest received or accrued is fully taxable, except interest on certain tax-exempt state or municipal bonds that satisfy the requirements set forth in Internal Revenue Code sections 103 and 141-150. However, taxpayers holding qualified tax credit bonds (QTCBs) on specified “credit allowance dates” during the taxable year are entitled to a nonrefundable credit (rather than interest payments) against regular income tax and alternative minimum tax liability. The credit accrues quarterly and is includible in gross income as interest is paid on the bond. The amount of the credit is determined by multiplying the bond’s credit rate by its face amount. The credit rate is determined by the Internal Revenue Service and is a rate that allows the bonds to be issued without discount and interest cost to the issuer.

On February 17, 2009, President Obama signed into law "The American Recovery and Reinvestment Act of 2009" (P.L. 111-5) (ARRA). Section 1531 of ARRA contains an amendment to the Internal Revenue Code that established a new type of QTCB —“Build America Bonds” (BABs). A BAB is a bond issued prior to January 1, 2011, by a state or local entity for “governmental” (non-private activity) purposes and for which the issuer elects to have the interest on the bond be taxable, in return for a federal interest subsidy. Under the BAB program, issuers could choose one of two types of assistance:

1. A subsidy paid directly to the municipal issuer of approximately 35 percent of the BAB interest costs for a given issue; or
2. A tax credit of 35 percent that would be available to the purchaser of a BAB.

The diagram below illustrates the two variants of BABs:¹

10% Build America Bonds: Direct Pay vs. Tax Credit Structure



¹ Source: **Build America Bonds: A Preliminary Assessment** A Briefing Paper prepared for the American Association of State Highway and Transportation Officials May 29, 2009. http://www.transportation-finance.org/pdf/funding_financing/financing/build_america_bonds_prelim_assessment.pdf

BABs are intended to help state and local governments stimulate the economy and create jobs by providing a subsidized vehicle for financing capital projects. BAB issuers can offer higher interest rate payments that could be attractive to investors that would be uninterested in standard municipal bonds.

The BAB program expired at the end of 2010. However, President Obama's fiscal 2012 budget, released on February 14, 2011, proposes to permanently reinstate the BAB program with a lower, 28 percent subsidy rate.

Under Article 13, Section 26(b), of the California Constitution, interest on bonds issued by the state of California or any local government in California is exempt from taxes on income. However, because the franchise tax is a tax on the privilege of doing business within the state rather than a tax on income, interest on these bonds is taxable income for taxpayers subject to the corporate franchise tax.² The federal rules under Internal Revenue Code sections 103 and 141-150 that look to (1) the source of payment of that bond or its security, public or private, and (2) whether or not public improvements are financed are not relevant for determining whether interest on such bonds are taxable for state purposes.

There is no provision for QTCBs under current state law.

THIS BILL

This bill would establish, under the Government Code, the Build California Bonds (BCBs) Program. The BCB program would authorize the California Transportation Financing Authority (Authority) to issue BCBs for the purpose of financing or refinancing transportation projects. The total amount of BCBs that could be issued would be limited to \$1 billion per fiscal year for each of the five fiscal years beginning with fiscal year 2011-2012, for a total of \$5 billion. Any portion of the annual \$1 billion authorization that is not used could be used in a future fiscal year; however, the aggregate amount of credits for all BCBs issued may not exceed \$250 million for any fiscal year.

Under the Government Code, this bill would do all of the following:

- Define a number of terms and phrases including, "Authority," "Build California Bonds," "transportation project," and "record date." BCBs would be defined as bonds, as defined³, that entitle the beneficial owners to a California state tax credit.
- Limit the amount of the credit to the greater of 5 percent of the face amount of the bonds outstanding or the yield required to market the bonds at par value.
- Specify that the amount of the credit would be determined by the Authority on or prior to the issue date of a BCB. The California state tax credits would be claimable semiannually on any interest payment date on the bonds.
- Specify that the amount of the tax credit on a BCB for any calendar year would be equal to the principal amount of the BCB multiplied by the percentage rate as specified.

² Revenue and Taxation Code section 24272.

³ Government Code Section 63010(e)

- Specify that the credit for a BCB outstanding for less than a full year preceding the record date would be allocated to the beneficial owner of the BCB based upon the number of days the BCB was outstanding.
- Allow the holder of a BCB to claim a nonrefundable tax credit on the holder's personal or corporate state tax return at the time the holder files that return.
- Allow a tax credit, as specified, for each calendar year beginning on or after January 1, 2012, to a beneficial owner of a BCB. Credits in excess of the "tax," as defined, or "net tax," as defined, could be carried over for ten taxable years.
- Allow for the separation of the ownership of the BCB and the entitlement to the credit and provide that the credit in this situation would be allowed to the "person that on the credit allowance date holds the instrument evidencing the entitlement..."
- Require that the Authority or the indenture trustee for the BCB do all of the following:
 - Certify the amount of each annual tax credit;
 - Issue documentation of the tax credit to registered BCB owners, obtain from the registered BCB owners the name, taxpayer identification number, and amount of tax credit for each beneficial owner, and provide this information to the FTB; and
 - Request that the registered owners provide a copy of the information on a beneficial owner provided to the FTB to that beneficial owner.
- Specify that no credit for any taxable year shall be allowed unless and until a taxpayer retains a copy of the information received from the registered owner, provides it to the FTB upon request, and provides the BCB's registered owner with the taxpayer's taxpayer identification number.

Under the Revenue and Taxation Code (R&TC), an income or franchise tax credit as provided for under the Government Code would be allowed as a credit against the tax (Personal Income Tax) or net tax (Corporation Tax Law). The credit would be nonrefundable and any amount in excess of the tax or net tax could be carried forward as provided for in the Government Code.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is working with the author's office to resolve these and other concerns that may be identified.

The calculation of the credit, the identification of the entity that is entitled to the credit, certifying and reporting credit information to the FTB, and the timing for reporting the credit on a return are spread among several Government Code and R&TC Sections. Additionally, there are multiple and inconsistent references to the same subject, e.g., the amount of the credit and who would be eligible for the credit. Generally, the language defining a tax credit that would be administered by the FTB would appear in unambiguous language within the Personal Income Tax Law and the Corporate Tax Law under the R&TC. For ease of administration, clarity of language, internal harmony within the affected California codes, and consistency with existing credit language within the R&TC, it is recommended that this bill be amended.

This bill uses terms and phrases that are undefined, i.e., “beneficial owners,” “bond,” “holder,” “indenture trustee,” and “instrument evidencing the entitlement.” Additionally, some of these terms appear to be used interchangeably. The absence of definitions to clarify these terms and inconsistency of usage could lead to disputes with taxpayers and would complicate the administration of this credit.

It is unclear when and how the credit would be reported because the bill language states that the credit would be allowed on the record date and would be claimed on each interest payment date. For ease of compliance and administration, it is suggested that the author amend this bill to eliminate the inconsistent language.

It is unclear how a fiscal year taxpayer would report the calendar year credit that this bill would allow. For example, would a taxpayer with a fiscal year ending on June 30 report the credit for the calendar year 2012 on their return for the fiscal year ending June 30, 2013? Prorate the calendar year credit between the fiscal years ending in 2012 and 2013? Generally tax credits are allowed based on a taxable year to address both calendar year and fiscal year filers. The author may wish to amend this bill to reflect credit language that is consistent with the structure and style of existing income and franchise tax credits.

The credit would be denied “for any taxable year unless the taxpayer subsequently complies” with certain requirements. The bill lacks administrative details that impact the department’s ability to administer this requirement. For example, how would the department be made aware of a taxpayer’s lack of compliance? Would the credit be denied for all years that the credit had been claimed or would the denial be limited to the taxable year related to the lack of compliance? How would the department restore the credit upon a taxpayer’s return to compliance? For ease of administration and compliance, it is recommended that this bill be amended.

Under existing corporation tax law, certain tax credits may be assigned, as specified. This bill would allow for the separation of the ownership of the BCB and the entitlement to the credit and provide that the credit in this situation would be allowed to the “person that on the credit allowance date holds the instrument evidencing the entitlement.” Because the bill fails to state otherwise, the credit this bill would establish would be eligible for assignment. It is unclear how the assignment of credits allowed under the R&TC and the ability, under the Government Code, to separate the bond’s ownership from entitlement to the credit would interact. If it is the author’s intention that this credit would be ineligible for assignment under the R&TC, this bill should be amended.

LEGISLATIVE HISTORY

AB 2687 (Bradford, 2009/2010) would have, among other things, created a corporate tax credit for trade infrastructure investment constructed in this state. AB 2687 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

No existing state credits similar to the credit this bill would establish were identified.

FISCAL IMPACT

The department's costs to administer this bill are unable to be determined until implementation concerns have been resolved. As the bill continues to move through the legislative process and implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Estimated Revenue Impact of SB 867 For Taxable Years Beginning On or After January 1, 2012 Enactment Assumed After June 30, 2011 (\$ in Millions)		
2011-12	2012-13	2013-14
-\$20	-\$65	-\$120

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

SUPPORT/OPPOSITION

Support: Los Angeles Metropolitan Transportation Authority
Associated General Contractors

Opposition: None Identified To Date.

ARGUMENTS

Pro: Encouraging investment in the state's transportation infrastructure could result in job growth as projects receive funding.

Con: Providing a tax credit for investing in tax exempt bonds targeted solely for transportation projects ignores the critical need for investment in other areas such as education and health care.

LEGISLATIVE STAFF CONTACT

Jahna Alvarado

Legislative Analyst, FTB

(916) 845-5683

jahna.alvarado@ftb.ca.gov

Patrice Gau-Johnson

Asst. Legislative Director, FTB

(916) 845-5521

patrice.gau-johnson@ftb.ca.gov